

Message Text

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ACTION EA-09

INFO OCT-01 IO-13 ISO-00 AID-05 CIAE-00 COME-00 EB-07
FRB-03 INR-07 NSAE-00 USIA-06 TRSE-00 XMB-02 OPIC-03
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R 170806Z JAN 77

FM AMEMBASSY SEOUL
TO SECSTATE WASHDC 1561
INFO AMEMBASSY TOKYO
AMEMBASSY TAIPEI
USMISSION GENEVA
USDEL MTN GENEVA
AMCONSUL HONG KONG

C O N F I D E N T I A L SECTION 1 OF 2 SEOUL 0414

HONG KONG FOR REFGINATT

EO 11652: GDS

TAGS: EFIN ETRD ECON GATT MTN KS

SUBJ: DEVALUATION RUMORS STIRRED BY ROKG MINISTER'S COMMENTS

SUMMARY: CONTROVERSIAL COMMENTS BY THE ROKG MINISTER OF COMMERCE AND INDUSTRY ON DECEMBER 29 IMPLYING THAT HE WAS RECOMMENDING A DEVALUATION OF THE WON HAVE PROMPTED A SHARP RISE IN BLACK MARKET CURRENCY RATES AND TOUCHED OFF DISCUSSIONS ON THE DESIRABILITY OF DEVALUATION WITHIN LOCAL BUSINESS AND BANKING CIRCLES. AFTER TWO WEEKS OF OFFICIAL SILENCE, FINANCE MINISTER KIM YONG-HWAN FINALLY PUBLICLY DENIED A DEVALUATION WAS BEING CONSIDERED DURING A JANUARY 15 PRESS CONFERENCE. BASED ON SOUNDINGS IN GOVERNMENT, BUSINESS AND BANKING CIRCLES, AS WELL OUR OWN ANALYSIS OF CURRENT ECONOMIC CIRCUMSTANCES, WE BELIEVE A DEVALUATION AT THE PRESENT TIME IS EXTREMELY IMPROBABLE; BUT THE ISSUE COULD BECOME ACTIVE LATER IF
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KOREA'S EXPORTS SHOWS SERIOUS SIGNS OF FALTERING.
END SUMMARY:

1. PUBLICLY REPORTED REMARKS OF DECEMBER 29 BY ROKG MINISTER OF COMMERCE AND INDUSTRY CHANG YI JOON, IN WHICH HE APPEARED TO BE CALLING FOR A DEVALUATION OF THE WON, HAVE TOUCHED OFF CONSIDERABLE DISCUSSION IN

KOREAN BUSINESS AND FINANCIAL CIRCLES ABOUT THE DESIRABILITY OF FURTHER DEVALUATION. ALTHOUGH THERE IS VIRTUAL UNANIMITY AMONG INFORMED SOURCES THAT A DEVALUATION AT ANY TIME IN THE NEAR FUTURE IS HIGHLY IMPROBABLE, THE BLACK MARKET WON/DOLLAR RATIO HAS REPORTEDLY RISEN TO ABOUT 550 WON/US DOLLAR (AS COMPARED TO THE OFFICIAL RATE OF 484/1). A DELIBERATE POSTURE OF PUBLIC SILENCE BY MINISTRY OF FINANCE OFFICIALS ON THE QUESTION WAS FINALLY BROKEN JANUARY 15 WHEN FINANCE MINISTER KIM YONG-HWAN RESPONDED TO REPORTERS' QUESTIONS WITH A FIRM DENIAL THAT THE ROKG WAS GIVING ANY CONSIDERATION TO DEVALUATION.

2. CHANG'S CONTROVERSIAL COMMENTS WERE INCLUDED IN HIS PRESENTATION TO THE DECEMBER 29 EXPORT PROMOTION MEETING, A MONTHLY AFFAIR, PRESIDED OVER BY PRESIDENT PARK CHUNG-HEE, AND ATTENDED BY BOTH ROKG OFFICIALS CONCERNED WITH EXPORT PROMOTION AND REPRESENTATIVES OF MAJOR EXPORTING FIRMS AND INDUSTRIES. AS REPORTED IN PREESS COVERAGE OF THE MEETING, CHANG REFERRED TO KOREA'S "REAL EFFECTIVE EXCHANGE RATE" WHICH HE SAID HAS DECLINED TO 394 WON/US DOLLAR. HE REPORTEDLY SUGGESTED THAT THIS "REAL EFFECTIVE EXCHANGE RATE" SHOULD BE RESTORED TO ABOUT 484 WON/US DOLLAR. THIS "REAL EFFECTIVE EXCHANGE RATE" IS DEFINED AS THE NOMINAL EXCHANGE RATE (484/1) PLUS THE VALUE OF EXPORT SUBSIDIES, BUT DEFLATED BY THE INCREASE IN KOREA'S WHOLESALE PRICE INDEX (WPI) RELATIVE TO INCREASES IN THE WHI'S OF THE U.S. AND JAPAN OVER
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THE SAME PERIOD.

3. A KOREAN EXPORTER WHO ATTENDED THE MEETING TOLD US THAT CHANG'S REMARKS WERE MADE IN THE CONTEXT OF A BROADER DISCUSSION OF THE OBSTACLES KOREA FACES IN TRYING TO ACHIEVE ITS EXPORT TARGETS FOR THE FOURTH FIVE-YEAR PLAN (1977-81) AND THAT THE NEWS STORIES WERE MISLEADING IN INDICATING THAT CHANG WAS SPECIFICALLY RECOMMENDING RESTORATION OF THE "REAL EFFECTIVE EXCHANGE RATE" TO 484/U.S. DOLLAR. THE SAME SOURCE ALSO REPORTED THAT DEPUTY PRIME MINISTER NAM DUCH-WOO SOUGHT TO CLARIFY CHANG'S REMAKRS DURING THE SAME MEETING BY MAKING IT CLEAR A DEVALUATION WAS NOT BEING CONSIDERED.

4. PRESS COVERAGE OF THE MEETING DID NOT MENTION NAM'S CLARIFICATION; BUT A JANUARY 5 ARTICLE IN A LOCAL TRADE PUBLICATION REPORTED THAT DPM NAM HAD SUBSEQUENTLY RESPONDED TO REPORTERS' QUESTIONS BY

MAKING IT CLEAR THE GOVERNMENT HAD NO INTENTION OF
DEVALUING THE WON, AT LEAST DURING 1977, AND HAD
EVEN SUGGESTED THAT KOREA COULD, IF ANYTHING, COME
UNDER PRESSURE FROM ITS TRADING PARTNERS TO REVALUE THE
WON UPWARDS IN LIGHT OF ITS EXCELLENT TRADE
AND BALANCE OF PAYMENTS PERFORMANCE IN 1976.

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5. IN PRIVATE CONVERSATIONS WITH EMBASSY OFFICERS,
ROKGO OFFICIALS HAVE BEEN EQUALLY ADAMANT IN DENYING
THAT A DEVALUATION IS BEING CONSIDERED. POINTING TO
LAST YEAR'S 50 PERCENT PLUS INCREASE IN EXPORTS AND
THE STEEP INCREASE IN FOREIGN EXCHANGE RESERVES
(\$2,940 MILLION AS OF DECEMBER 31, UP \$1.4
BILLION FOR THE YEAR), THEY ARGUE THAT:
(1) THERE IS OBVIOUSLY NO NEED FOR DEVALUATION;
(2) IT WOULD BE ALMOST IMPOSSIBLE TO JUSTIFY IT TO THE IMF;
(3) IT COULD STIMULATE EVEN FURTHER PROTECTIONIST
SYMPATHIES IN INDUSTRIAL NATIONS;
(4) IT WOULD ONLY TRIGGER COMPETITIVE DEVALUATIONS
BY SUCH OTHER EAST ASIAN SUPPLIERS AS THE REPUBLIC OF
CHINA AND KONG KONG; AND
(5) IT WOULD BE INCONSISTENT WITH THE HIGH
PRIORITY BEING GIVEN DOMESTIC PRICE STABILIZATION.

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6. EMBASSY SOUNDINGS IN THE BUSINESS AND FINANCIAL COMMUNITY OVER THE PAST TWO WEEKS SUGGEST THAT EVEN AMONG EXPORTERS SENTIMENT FOR A DEVALUATION IS DECIDEDLY MIXED. WHILE CONCEDED THAT RISING PRODUCTION COSTS ARE ERODING PROFIT MARGINS ON EXPORTS, SOURCES IN MAJOR EXPORT PRODUCING FIRMS POINT OUT THAT ANY GAINS IN WON RECEIPTS FROM A DEVALUATION WOULD BE LARGELY OFFSET BY HIGHER WON OUTLAYS TO SERVICE THEIR HEAVY FOREIGN DEBT LOADS. THEY ARGUE THAT PRESSURE FOR A DEVALUATION IS LARGELY LIMITED TO TRADING FIRMS OR THE SMALLER EXPORTERS WHO DO NOT HAVE SUBSTANTIAL FOREIGN LOAN OBLIGATIONS. THERE WAS VIRTUAL UNANIMITY AMONG THE BEST INFORMED SOURCES IN BOTH BUSINESS AND BANKING CIRCLES THAT A DEVALUATION AT THIS TIME IS EXTREMELY UNLIKELY.

7. WE HAVE HEARD FROM SEVERAL SOURCES THAT CHANG'S REMARKS WERE REALLY INTENDED AS A COUNTER-ATTACK TO PROPOSALS EMANATING FROM THE BANK OF KOREA AND THE MINISTRY OF FINANCE TO REDUCE MODERATELY THE LEVEL OF SUPPORT FOR EXPORT INDUSTRIES. CHANG'S AIM, IN THEIR VIEW, WAS NOT TO PRESS FOR DEVALUATION, BUT RATHER TO FEND OFF PRESSURE FOR REDUCING SUBSIDIES.

8. COMMENT: CHANG'S COMMENTS ON THE "REAL EFFECTIVE EXCHANGE RATE" WERE APPARENTLY BASED ON MATERIAL AND COMPUTATIONS CONTAINED IN A CONFIDENTIAL REPORT TO THE ROKG PREPARED BY PROFESSOR BELA BALASSA OF JOHNS HOPKINS UNIVERSITY IN HIS CAPACITY AS AN IBRD CONSULTANT (WE HAVE OBTAINED A COPY OF THIS REPORT). IN USING THIS MATERIAL THE WAY HE DID, CHANG IGNORED BOTH: (1) THE FACT THAT BALASSA ARGUED FOR DISCARDING THOSE COMPUTATIONS IN FAVOR OF A MODIFIED REAL EFFECTIVE EXCHANGE RATE" WHICH SHOWS LESS MARKED CHANGE AND ACTUALLY SHOWS A SLIGHT DEPRECIATION OF

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THE MODIFIED REAL EFFECTIVE EXCHANGE RATE FROM 1974 TO 1975 WHEN A PRODUCTION COST INDEX IS SUBSTITUTED FOR KOREA'S WPI; AND (2) THAT BALASSA'S POINT WAS INTENDED AS ONLY ONE PART OF A MUCH BROADER DISCUSSION OF INCENTIVES FOR ECONOMIC GROWTH.

9. BASED ON BOTH THE REACTION WE HAVE OBTAINED FROM INFORMED BUSINESS, BANKING, AND GOVERNMENT SOURCES AS WELL AS OUR OWN ANALYSIS OF KOREA'S CURRENT ECONOMIC CIRCUMSTANCES, WE BELIEVE A DEVALUATION AT THE PRESENT TIME IS EXTREMELY IMPROBABLE. AT THE SAME TIME, THE PROSPECT THAT KOREA'S RATE OF INFLATION WILL CONTINUE TO BE HIGHER THAN THOSE OF ITS MAJOR TRADING PARTNERS AND COMPETING SUPPLIER NATIONS MEANS THAT FURTHER DEVALUATION OF THE WON SOMETIME IN THE FUTURE IS PROBABLY INEVITABLE. SHOULD KOREA'S EXPORT PERFORMANCE SHOW ANY DECIDED WEAKNESS IN COMING MONTHS, PARTICULARLY RELATIVE TO THE PERFORMANCES OF SUCH COMPETITORS AS TAIWAN AND HONGKONG, THE QUESTION OF DEVALUATION COULD COME UNDER SERIOUS CONSIDERATION BY MID-YEAR OR SHORTLY THEREAFTER.
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Disposition Case Number: n/a
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TAGS: EFIN, ETRD, ECON, KS, GATT, MTN
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